

# Lease of Building With Related Party

\*\*Disclaimer – The exposure draft received nearly 700 letters of comment through the comment period ended December 15, 2010. There is some expectation that key features of the standard will be modified as a result of constituent response. As a result, these illustrative examples will not likely be accurate or appropriate to rely upon after issuance of the final standard. We have provided these as an educational tool only and do not represent these examples to be accurate under current or future final standards. Any templates used in the examples below are for internal use only and are not available for distribution.

**Leasing example - Lease of building with related party (not deemed a Variable Interest Entity) where the lease term is either month-to-month or is one year at a time**

**Subject:**

*ABC Corporation has entered into a lease for warehouse and office space*

**Details:**

The lease terms are as follows:

Tenant:	ABC Corporation (ABC)
Lessor:	General Properties, LLC (GP, LLC)
Premises:	9999 Building, totaling 20,000 rentable square feet
Term:	Month to month
Lease Date	Lease originated 2002
Base Rental:	\$36,666 per month triple-net lease
Initial Direct Costs	None
Commissions	None
Security Deposit:	None
Free Rent Period:	None
Option to Extend:	None
Subletting:	Not addressed
Build Out Allowance:	None
Residual Value Guarantees:	None
Purchase Option	None

Other relevant assumptions:

Incremental borrowing:	The incremental borrowing rate of ABC Corporation is 7%
Rate charged by Lessor	8%
Likelihood of extension:	100% certain in short-term
Reassessment:	Throughout the period, no reassessment of contingent rentals, residual value guarantees or impairment occur
Amortization:	The Right to Use Asset will be amortized straight line over the life of the lease

**Analysis:**

While this may appear to be a simple short-term lease upon first blush, the related party factor can substantially alter the outcome. Although the lease may be short-term (or nonexistent), the most likely outcome is that ABC will continue to rent the facility for an undefined period of time in the future. Based on that result, a right-to-use asset is created.

This is an example where the facts and circumstances will be unique in most every scenario and will require analysis based upon those facts and circumstances. Determining the longest lease period that is more likely than not to occur requires considerable judgment.

Once the most-probable outcome is determined, the financial statement impact will be similar to the examples presented elsewhere. The factors to be considered include:

- Discount rate
  - Same analysis as in other examples
- Most-probable longest lease term
  - History of the lease
    - How long has ABC been leasing the space?
  - Debt on the facility
    - Is the most-probable minimum lease term the period of time that would be needed to service the debt?
  - Remaining economic useful life of the facility
  - Age, condition, and suitability of the facility
    - Will major renovations or improvements be needed in the near future?
    - Will the facility continue to meet the needs of ABC's business plans?
  - GP, LLC (and owner)'s overall business plan. For example, do they plan to operate ABC for 10 years and then sell? Do they plan to sell the building?
- Lease rate
  - History of the lease – What changes have occurred historically?
  - Any planned rate modifications?
  - Any plans for renovations/expansions/improvements?
- Identifying indirect costs
  - History of the lease – Who has paid costs in the past and what type of costs (if any) have there been?
  - Plans for renovations/expansions/improvements?

Note that the lease must be reassessed each period with particular attention paid to the determined lease period.